IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, Plaintiff, v. ENRON CORPORATION, et al., Defendants.	§	CIVIL ACTION NO.: H 01-3624 AND CONSOLIDATED CASES

DEFENDANT JOHN A. URQUHART'S REPLY IN SUPPORT OF MOTION TO DISMISS (RESPONDING TO PLAINTIFFS' OPPOSITION TO MOTION TO DISMISS) AND JOINDER IN OUTSIDE DIRECTORS' REPLY IN SUPPORT OF MOTION TO DISMISS CONSOLIDATED COMPLAINT

TO THE HONORABLE MELINDA HARMON:

Defendant John A. Urquhart respectfully submits this Reply in response to Plaintiffs' Opposition to Urquhart's Motion to Dismiss the Consolidated Complaint ("CC"). Plaintiffs have not separately opposed Urquhart's Motion to Dismiss, but instead have included their response to Urquhart's motion in their opposition to the group motion of certain Outside Directors. Accordingly, to avoid duplication of arguments and unduly burdening the Court with additional briefing materials, Urquhart hereby joins in and incorporates by reference the Reply in Support of Motion to Dismiss Consolidated Complaint of Defendants Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert Jaedicke, Charles A. LeMaistre, John Mendelsohn, Jerome Meyer, Paulo Ferraz Pereira, Frank Savage, John Wakeham, Charls E. Walker, and Herbert S. Winokur (hereinafter "Outside Directors

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Reply"). As a supplement to the Outside Directors' Reply, Urquhart respectfully asks the Court to consider the following additional points with particular reference to Urquhart.

I. Overview

In his Motion to Dismiss, Urquhart noted that he is mentioned by name in only 16 of the 1030 paragraphs of the CC, and that those references appear principally intended to place him biographically or to note that he signed certain public filings as a director. The CC attempted to assert liability against Urquhart under § 11[1] of the 1933 Securities Act relating to three debt offerings, and under the Texas Securities Act ("TSA") relating to two different debt offerings. Plaintiffs now have dropped their claims under § 11 concerning the 7% Exchangeable Notes, so the only purported claims for which Plaintiffs are targeting Urquhart are alleged violations of § 11 relating to two debt offerings—the 5/19/99 Offering and the 5/18/00 Offerings—and alleged state-law violations of the TSA.

II. The § 11 Claims Against Urquhart Must Be Dismissed Because the Face of the Complaint Demonstrates That He Has a Complete Defense to Those Claims.

As demonstrated in Urquhart's Motion to Dismiss and in the Outside Directors' Reply, the CC itself establishes Urquhart's absolute defense to the § 11 claims, since he is not liable for the parts of a registration statement "purporting to be made on the authority of an expert" on which he reasonably relied. 15 U.S.C. § 77k(b)(3)(C). And, as pointed out with references in Urquhart's Motion to Dismiss and in the Outside Directors' Reply, it is clear from the face of the CC that all of Plaintiffs' allegations of false or misleading information in the registration statements concern the accounting treatment or structuring of Enron's financial transactions—activities which Plaintiffs specifically attribute to Anderson and Enron's legal experts.

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[1] The CC also asserts unsupported "controlling person" claims against Urquhart under § 15 of the 1933 Securities Act that allegedly relate to § 11. Urquhart respectfully refers the Court to his Motion to Dismiss at 17-19, the Motion to Dismiss of Outside Directors at 72-75, and the Outside Directors' Reply for a discussion of the inapplicability of § 15 liability as to Urquhart.

Although Plaintiffs now take a stab at arguing that "the falsity of these Registration Statements was not confined to false financial statements" (Plaintiffs' Opposition at 86), this contention is belied by the CC.[2] By way of example, the CC asserts: that "Andersen . . . was involved in every facet of Enron's business. Andersen audited Enron's financial statements, it acted as internal auditors for Enron, it prepared Enron's tax returns, it provided consulting services on a wide range of topics and consulted on the accounting for the very transactions at issue in the litigation throughout the Class Period" (CC ¶ 897); that "Andersen . . . was intimately familiar with Enron's business affairs and its personnel were present at Enron's Houston headquarters on a year-round basis" (*id.*); that the LJM transactions were "structured, reviewed, and approved by Andersen, Vinson & Elkins, Kirkland & Ellis, and certain of Enron's banks" (CC ¶ 32); that "[m]isleading disclosures were crafted and approved by Enron's outside auditors and its outside counsel" (CC ¶ 67); that "Andersen not only permitted Enron to falsify its financial results and falsely certify them, but actually actively engaged and participated in structuring transactions to help falsify Enron's financial results" (CC ¶ 70(a)); and that "Andersen in fact offered Enron advice at every step, from inception through restructuring and ultimately terminating the Raptors. Enron followed that advice." (CC ¶ 953).

Thus, as set forth fully in Urquhart's Motion to Dismiss and in the Outside Directors' Reply, because Plaintiffs have pleaded that Urquhart received and relied upon the expert accounting opinions of Andersen and the expert legal opinions of Enron's counsel, Plaintiffs have conclusively established Urquhart's defense under § 11.

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[2] Of course, "it is axiomatic that the Complaint cannot be amended by the briefs in opposition to a motion to dismiss." *In re BMC,* 183 F. Supp.2d 860, 915 (S.D. Tex. 2001).

III. Because Plaintiffs Have Chosen To Premise Their § 11 Claims On Fraud And Plaintiffs Have Admitted That Urquhart Did Not Commit Fraud, Plaintiffs' Claims Against Urquhart Must Be Dismissed.

The CC and Plaintiffs' Opposition expressly state that "no allegations of fraud are made against or directed at" Urquhart and certain other defendants. (See, e.g., CC at 3, n.1). This is understandable, since Plaintiffs do not allege that Urquhart engaged in any insider trading activities (CC at 490-91); or that Urquhart received any ill-gotten gains or profited in any respect from any improper Enron stock sales (*id.*); or that Urquhart participated in any wrongful schemes (CC at 488-90) or knowingly or recklessly participated in the preparation or dissemination of any false statements, misrepresentations, or omitted facts (*id.*).

Yet, viewed as a whole, the reality of the CC is that it accomplishes precisely what Plaintiffs purport to disavow—it stigmatizes Urquhart as an alleged participant in conduct that Plaintiffs variously label as scheming, manipulative, deceptive, and fraudulent. The taint on Urquhart is created because every alleged act, misstatement or omission on which liability under § 11 or the TSA is predicated is repeatedly described by Plaintiffs as part of "the most brazen, massive corporate fraud in history." (See, e.g., Plaintiffs' opposition at 1). Although Plaintiffs continue to pay passing lip service to their disclaimer of fraud allegations against Urquhart (Plaintiffs' Opposition at 1), every reference to the alleged statements, omissions and conduct about which Plaintiffs complain contains non-particularized, vitriolic accusations of fraud. A few examples from Plaintiffs' Opposition illustrate the point: "Enron's outside directors[']. . . approval of fraudulent transactions, conflicts of interest and deceptive accounting were at the center of the fraud. . ."; "The CC sets out in great particularity the participation of each of the Outside Directors in the Enron scheme"; "the CC avers specific facts that describe manipulative and deceptive devices these board members used to defraud Enron's investors, as well as their

knowing and reckless participation in various elements of Enron's scheme to defraud"; "[the alleged fraudulent transactions] were accomplished with the full knowledge of their risks and impropriety by the Board." (Plaintiffs' Opposition at 1-2). This is but a continuation of the allegations of fraud on which Plaintiffs rely in connection with their § 11 claims against Urquhart, including such descriptions as "egregious manipulations of Enron's financial statements" (CC ¶ 426); "Enron's scheme to hide the massive debt it was keeping off its books" (CC ¶ 506); "accounting manipulations" (CC ¶ 520); and "deceptive practices" (CC ¶ 558).

Indeed, in attempting to challenge Urquhart's entitlement to dismissal because of his reliance on the expertised portions of the registration statements, Plaintiffs flatly reveal that their claims against him are all hinged on fraud: "While the signers of these Registration Statements may be able at trial to establish a defense to liability for these expertised i.e., certified financial statements, in light of the CC's allegations that they ***knew*** those annual certified financial statements were false, they may not do so now at the 12(b)(6) stage." Plaintiffs' Response at 85, n.39 (emphasis added; citation omitted). Clearly, this is an allegation of fraud. *See, e.g., Weiss v. Blech,* 1995 WL 1137498, *2 (S.D. Tex. 1995)(allegations of *knowing*, reckless, or intentional behavior are allegations of fraud and require satisfaction of Rule 9(b) in a § 11 claim). And yet, unable to support any such nebulous theory of fraud against Urquhart, Plaintiffs momentarily purport to disown their accusations of intentional wrongdoing to attempt to circumvent the heavy burden of Rule 9(b): "descriptions herein of the Outside Directors' involvement in Enron's scheme to defraud do not apply to Mendelsohn, Meyer, Pereira, Savage, Urquhart, Wakeham, Walker and Winokur." Plaintiffs' Response at 1. Urquhart respectfully urges the Court not to

countenance such a mercurial approach to so serious a charge and to dismiss with prejudice all of Plaintiffs' unsubstantiated claims against him.[3]

The inescapable conclusion is that Plaintiffs cannot assert any factual basis for asserting fraud liability against Urquhart—much less the heightened pleading requirements under Rule 9(b) and the PSLRA—but they are unwilling to describe any member of the Board's conduct as anything but "brazenly" fraudulent. This is seemingly a matter of strategy, not oversight. If Plaintiffs were to plead that Urquhart's conduct was innocent, it might detract from their overall theme of widespread fraud and malfeasance. Thus, while momentarily contending otherwise for the purpose of seeking to sustain their claims against Urquhart, Plaintiffs in actuality have attempted to predicate liability against Urquhart only on the basis of incorporated allegations of intentional wrongdoing. So, without any basis for alleging complicity by Urquhart in any manipulative scheme, and realizing that any claims brought against Urquhart for fraud would be dismissed as lacking particularized facts, Plaintiffs have resorted to the empty statement that fraud is not being alleged against Urquhart. Under these circumstances, and as pointed out in Urquhart's Motion to Dismiss and in the Outside Directors' Reply, dismissal of all claims against Urquhart is appropriate.

As the United States Court of Appeals for the Fifth Circuit has stated: "When 1933 Securities Act claims are grounded in fraud rather than negligence . . . Rule 9(b) applies." *Melder v. Morris,* 27 F.3d 1097, 100 n.6 (5th Cir. 1994)(affirming dismissal of claims under §§ 11, 12(2) and 15 of the 1933 Act due to inadequate pleading of scienter). This is a salutary rule. As the court noted in *Taam Associates, Inc. v. Housecall Medical Resources, Inc.,* 1998 WL

[3] For the same reason, the claims against Mendelsohn, Meyer, Pereira, Savage, Wakeham, Walker and Winokur should also be dismissed.

1745361, *12 (N.D. Ga. 1998)(dismissing § 11 claims concerning financial statements for failure to plead fraud with particularity):

> Essentially, plaintiffs allege that defendants knew that they failed to follow GAAP and deliberately failed to provide adequate reserves for doubtful accounts. Moreover, a purpose is given for the failure to disclose this information. Namely, plaintiffs allege that defendants had to create an "illusion of financial strength and a high price for its stock" to raise sufficient funds through the IPO to obtain a waiver under a credit agreement with NationsBank. Plaintiffs are not alleging that defendants' non-compliance with GAAP arose from an arithmetic or accounting mistake. Instead, they indicate that defendants purposefully set its reserves low so that it could project a false sense of financial strength to unsuspecting purchasers who would then buy the resultingly overpriced stock. ***Clearly, this is an allegation of fraud. Its mere presence could operate to injure the reputations of the defendants in this case.***

Id. at *15 (emphasis added). Thus, Rule 9(b) imposes a stringent pleading requirement for fraud allegations "in order to give notice to defendants of the plaintiffs' claim, to protect defendants whose reputation may be harmed by meritless claims of fraud, to discourage "strike suits," and to prevent the filing of suits that simply hope to uncover relevant information during discovery." *Doyle and H.P. Leasing, Inc. v. Hasbro, Inc.,* 103 F.3d 186, 194 (1st Cir. 1996).

Plaintiffs' hollow characterization of their § 11 claims as something other than fraud-based cannot change the fact that those claims are actually and fundamentally predicated on allegations of fraud.[4] Thus, as this Court has recognized, when a § 11 claim sounds in fraud, plaintiffs must satisfy the heightened pleading requirements of Rule 9(b) and "must at least plead specific time, place and contents of the false representation and the identity of the person making the representation as well as what the person obtained thereby." *Kurtzman v. Compaq Computer Corp.,* Slip Op. at 163-64 (S.D. Tex. 2000). Because Plaintiffs here have utterly failed to plead with specificity any alleged fraudulent conduct by Urquhart, there simply is no basis for § 11 liability against him. The claims must be dismissed.

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[4] If "a rose by any other name would smell as sweet," then surely an accusation of fraud, however labeled, sullies as badly.

IV. Conclusion

For the reasons expressed in Urquhart's Motion to Dismiss and above, and in the Outside Directors' Reply, Defendant John A. Urquhart respectfully urges the Court to dismiss all claims asserted against him with prejudice. A form of order reflecting this requested relief accompanies this reply.

Respectfully submitted,

By: _____

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Defendant John A. Urquhart's Reply in Support of Motion to Dismiss (Responding to Plaintiffs' Opposition to Motion to Dismiss) and Joinder in Outside Directors' Reply in Support of Motion to Dismiss Consolidated Complaint was served on counsel of record pursuant to the Court's April 4, 2002 Order Regarding Service of Papers and Notice of Hearings, on this 24th day of June, 2002.

Please see attached Service List

H. Bruce Golden

The Service List

Attached

to this document

may be viewed at

the

Clerk's Office